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In The
Supreme Court of the United States

MHN GOVERNMENT SERVICES, INC. ET AL.,
Petitioners,

v.

THOMAS ZABOROWSKI ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICUS CURIAE* DRI—THE VOICE OF THE DEFENSE BAR IN SUPPORT OF PETITIONERS MHN GOVERNMENT SERVICES, INC. ET AL.

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INTEREST OF *AMICUS CURIAE*[1]

Amicus curiae DRI—The Voice of the Defense Bar (DRI) is an international organization that includes more than 21,000 members involved in the defense of civil litigation. DRI has long been a voice in the ongoing effort to make the civil justice system more fair and efficient. To that end, DRI regularly participates as *amicus curiae* in cases that raise issues of vital concern to its members, their clients, and the judicial system.

This case is of significant interest to DRI because its members routinely represent clients seeking to compel arbitration of claims brought under wage and hour, consumer protection, or other state laws that are subject to binding arbitration clauses. Accordingly, DRI's members are familiar with the common occurrence of state and federal courts refusing to enforce arbitration clauses (including in class action litigation) because of state public policy, unconscionability principles, or other tenets of state law.

This case is another in a long line of state and federal court decisions refusing to enforce the

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[1] This brief was authored by *amicus curiae* and its counsel, and was not authored in whole or in part by counsel for a party. No one other than *amicus curiae*, its members, or its counsel has made any monetary contribution to the preparation or submission of this brief. All parties provided written consent to the filing of *amicus curiae* briefs, and this written consent is on file with this Court.

preemptive mandate of the Federal Arbitration Act (FAA) that arbitration clauses be enforced according to their terms. Of particular concern to DRI and its members is the Ninth Circuit's reliance on California's state-law doctrine of unconscionability, under which courts skeptical of arbitration evade the FAA's preemptive effect based on policy judgments about whether arbitration agreements are insufficiently fair. In doing so, these courts refuse to acknowledge the basic principle, embodied in the Supremacy Clause of the U.S. Constitution, that federal law preempts state laws where they stand as an obstacle to the purposes and objectives of the FAA.

The FAA was enacted to create "a body of uniform federal law governing contracts within its scope." *Medtronic AVE, Inc. v. Advanced Cardiovascular Sys., Inc.*, 247 F.3d 44, 54 (3d Cir. 2001). DRI and its members seek uniform application of the FAA across the nation in order to ensure that arbitration can achieve its basic purpose of resolving disputes efficiently, predictably, and at minimal cost. The Ninth Circuit's decision in this case, and the specific California unconscionability rules that it applies, thwart that goal. This Court should reverse.

SUMMARY OF ARGUMENT

The FAA was enacted "in response to widespread judicial hostility to arbitration," and requires courts to "'rigorously enforce' arbitration agreements according to their terms," including the terms setting "the rules under which that arbitration

will be conducted." *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2308-09 (2013) (citations omitted).

As this Court has recognized, "[s]tate courts rather than federal courts are most frequently called upon to apply the [FAA], including the Act's national policy favoring arbitration. It is a matter of great importance, therefore, that state supreme courts adhere to a correct interpretation of the legislation." *Nitro-Lift Techs., L.L.C. v. Howard*, 133 S. Ct. 500, 501 (2012) (per curiam). Unfortunately, state courts have long exhibited the very "judicial hostility towards arbitration that prompted the FAA" decades ago, and have employed "'a great variety' of 'devices and formulas'" to avoid enforcing arbitration agreements. *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 341 (2011) (citation omitted).

In recent years, state court resistance to arbitration agreements has been based on § 2 of the FAA, which provides that arbitration agreements must be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2012). Reasoning that unconscionability is a state contract law doctrine that can render "any contract" unenforceable, state courts have increasingly held arbitration agreements unenforceable by applying arbitration-specific unconscionability rules that are avowed to be only general principles of state unconscionability law even as they actually cloak a hostility to arbitration. The difficulty of determining whether an unconscionability analysis is being applied evenhandedly to an arbitration agreement has allowed these state courts to nullify arbitration agreements

under the guise of § 2's saving clause based on state policy grounds that are hostile to arbitration.

Recognizing this potential for manipulation of the unconscionability doctrine to evade FAA preemption, this Court held in *Concepcion* that "[t]he 'principal purpose' of the FAA is to 'ensur[e] that private arbitration agreements are enforced according to their terms'" and that states cannot—whether in the guise of unconscionability, public policy, or some other state-law defense—"require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." *Concepcion*, 563 U.S. at 343, 350 (citation omitted). The Court held that the FAA preempts such defenses where they "have a disproportionate impact on arbitration agreements" even though these defenses "presumably apply" to all contracts, because "a doctrine normally thought to be generally applicable, such as . . . unconscionability," can be "applied in a fashion that disfavors arbitration." *Id.* at 340-41. The Court concluded that the FAA preempts unconscionability defenses that would allow a state court to invalidate an arbitration agreement because it prescribes procedures that are undesirable for state policy reasons. *See id.* at 340-43, 349-51.

Despite *Concepcion*'s sharp rebuke that "California's courts" in particular "have been more likely" to apply their own state unconscionability laws to preclude the enforcement of arbitration agreements, *id.* at 341, courts applying California law have persisted in using arbitration-specific unconscionability rules as a rationale to resist the mandate of the FAA. The decisions of the district court and the Ninth

Circuit in this case are examples of this continuing post-*Concepcion* trend.

Both courts interpreted the arbitration clause in the standard counseling services contract of MHN Government Services, Inc. (MHN) by looking to California law—and Ninth Circuit cases interpreting California law—directly overruled by or in direct conflict with *Concepcion*. *See, e.g.*, Pet. App. 3a-5a, 19a. The lower courts' application of California law violates the Supremacy Clause of the U.S. Constitution, and California may not "opt out" of the Supremacy Clause. "When this Court has fulfilled its duty to interpret federal law, a state court may not contradict or fail to implement the rule so established. See U.S. Const., Art. VI, cl. 2." *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1202 (2012) (per curiam).

This brief will trace the history of California's efforts, both before and after *Concepcion*, to apply state-law unconscionability rules to avoid enforcing arbitration agreements according to their terms, as mandated by the FAA. Incorrect and disproportionate use of the unconscionability doctrine has permitted California courts to invalidate arbitration agreements they deem too unfair or one-sided, an analysis preempted by the FAA because it rests on policy judgments about the efficacy of arbitration for the vindication of a litigant's rights. Furthermore, California's unconscionability standards are preempted by the FAA because they take their meaning from the fact that an arbitration agreement is at issue, and as applied have a disproportionate impact on such agreements, particularly when California's state-law

severability rule is simultaneously applied in a manner unique to arbitration agreements. Finally, this brief will explain that, rather than applying ill-defined standards of fairness under the guise of an unconscionability analysis, courts should be limited to invalidating arbitration agreements based on unconscionability only when required to do so by constitutional due process requirements.

ARGUMENT

I. THE FAA PREEMPTS CALIFORNIA'S ARBITRATION-SPECIFIC UNCONSCIONABILITY RULES.

A. The question presented in this case encompasses whether California's unconscionability test, as applied to arbitration agreements, is preempted by the FAA.

The petition for a writ of certiorari here presents the question "whether California's arbitration-only severability rule is preempted by the FAA." Pet. i. As respondents concede, "[t]he significance of any impact that California's severance doctrine may have on the FAA's objectives depends, in the first instance, on the scope of the state's unconscionability doctrine." Pet. Opp. 32-33. This is unsurprising because, under California law, questions about whether specific terms can be severed from an arbitration agreement come into play only *after* a court first deems those terms to be unconscionable pursuant to state law, and this

severability analysis turns on the degree to which an "unconscionable taint" permeates the agreement. *See Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83, 121-25, 6 P.3d 669, 695-97 (2000). Consequently, the extent to which the California rules governing whether an arbitration agreement is unconscionable contravene the FAA necessarily influences how a court will assess the "unconscionable taint" in the agreement and apply the arbitration-only severability rule.

Because California's unconscionability rules are inextricably intertwined with the state's severability rule, this Court—in resolving whether California's arbitration-only severability rule is preempted by the FAA—can and should decide the antecedent question whether the FAA preempts California's unconscionability rules as applied to arbitration agreements.[2]

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[2] This Court's "power to decide [issues] is not limited by the precise terms of the question presented." *Procunier v. Navarette*, 434 U.S. 555, 559 n.6 (1978). Rather, that power extends to any question "essential" to the disposition of the issues in a case. *United States v. Mendenhall*, 446 U.S. 544, 551 n.5 (1980); *see also Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 173 n.1 (2009) ("[T]he statement of any question presented is deemed to comprise every subsidiary question fairly included therein." (citation omitted)).

B. The FAA precludes a court from refusing to enforce an arbitration agreement on the ground that its terms are undesirable as a matter of state public policy.

Before Congress enacted the FAA in 1925, courts viewed arbitration with disfavor in no small measure because of "judges' paternalistic attitude that only they could ensure that individual plaintiffs would be afforded a fair opportunity to challenge corporate defendants." Stephen A. Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts Are Circumventing the Federal Arbitration Act*, 3 Hastings Bus. L.J. 39, 42 (2006). Congress enacted the FAA to overcome this judicial hostility to arbitration agreements by requiring courts to place them "on an equal footing with other contracts" and "enforce them according to their terms." *Concepcion*, 563 U.S. at 338. The FAA preempts any contrary state law and is binding on state courts as well as federal. *Southland Corp. v. Keating*, 465 U.S. 1, 10-17 (1984).

Congress tempered the FAA's mandate to respect parties' freedom of contract by including in the FAA a saving clause that preserves from preemption generally applicable state-law contract defenses. 9 U.S.C. § 2; *see Concepcion*, 563 U.S. at 342. But even a contract defense that a state court characterizes as "generally applicable" is preempted by the FAA if the defense "'stands as an obstacle to the accomplishment and execution of the full purposes'" of the FAA. *Concepcion*, 563 U.S. at 340-42, 351 (citation omitted).

Concepcion held that the FAA preempted the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P.3d 1100 (2005), which had applied California's unconscionability standards to prohibit class action waivers in arbitration contracts. *Concepcion*, 563 U.S. at 339, 351. *Concepcion* emphasized that, while the FAA's saving clause "permits agreements to arbitrate to be invalidated by 'generally applicable contract defenses, such as fraud, duress, or unconscionability,'" the FAA preempts such defenses where they "have a disproportionate impact on arbitration agreements" even though these defenses "presumably apply" to all contracts. *Id.* at 338, 341 (citation omitted). *Concepcion* concluded that the FAA preempts unconscionability or public policy defenses that would allow a state court to invalidate an arbitration agreement on the ground it prescribes procedures that are undesirable for state policy reasons. *See id.* at 340-43, 349-51.[3]

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[3] Justice Thomas offered an additional basis for finding state-law unconscionability and public policy defenses preempted by the FAA when applied to invalidate an arbitration agreement. The saving clause in § 2 of the FAA, read in harmony with the plain language of the FAA's other provisions,

> require[s] enforcement of an agreement to arbitrate unless a party successfully asserts a defense concerning the formation of the agreement to arbitrate, such as fraud, duress, or mutual mistake. Contract defenses unrelated to the making of the agreement—such as public policy—could not be the basis for declining to enforce an arbitration clause.

(continued...)

In sum, *Concepcion* "found *Discover Bank* objectionable" because *Discover Bank* "allowed courts to ignore and refuse to enforce the clear terms of the parties' agreement, and instead employ a judicial policy judgment" that a procedure to which the parties did not contractually agree "would better promote the vindication of the parties' rights in certain cases." *Truly Nolen of Am. v. Superior Court*, 208 Cal. App. 4th 487, 506, 145 Cal. Rptr. 3d 432, 445 (2012); *see Italian Colors*, 133 S. Ct. at 2308-09 (holding that the FAA requires courts to "'rigorously enforce' arbitration agreements according to their terms," including the terms setting "the rules under which that arbitration will be conducted" (citation omitted)); *see also Italian Colors*, 133 S.Ct. at 2313 (Thomas, J., concurring) ("Italian Colors voluntarily entered into a contract containing a bilateral arbitration provision. It cannot

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(...continued)
Concepcion, 563 U.S. at 351-56 (Thomas, J., concurring) (citation omitted). The "[r]efusal to enforce a contract for public-policy reasons does not concern whether the contract was properly made" under California law. *Id.* at 356 (Thomas, J., concurring); *see also Cruz v. Cingular Wireless, LLC*, 648 F.3d 1205, 1212, 1215 (11th Cir. 2011) (applying Justice Thomas's analysis in *Concepcion* to affirm an order compelling arbitration in part because plaintiffs argued the arbitration agreement violated "public policy" and thus did "not allege any defects in the formation of the contract"). Justice Thomas therefore concluded that the FAA's saving clause did not preserve from preemption *Discover Bank*'s "'unconscionab[ility]'" rule because the rule was grounded in state public policy considerations rather than predicated on a concern for the making of a contract. *Concepcion*, 563 U.S. at 355-56 (Thomas, J., concurring).

now escape its obligations merely because the claim it wishes to bring might be economically infeasible.").

C. California's long resistance to FAA preemption based on arbitration-specific standards has continued unabated after *Concepcion*.

The Ninth Circuit's effort in this case to circumvent the FAA under the guise of applying a "neutral" California unconscionability rule is not a unique occurrence, but merely one example of a long-standing hostility among the state and lower federal courts towards the FAA. Notwithstanding this Court's rulings to the contrary, California courts aggressively refuse to enforce arbitration agreements. *See Concepcion*, 563 U.S. at 341. Time and again, this Court has been called on to eliminate barriers to arbitration put in place by California's legislature and courts. *See, e.g., id.* at 337-51; *Preston v. Ferrer*, 552 U.S. 346, 349-63 (2008); *Perry v. Thomas*, 482 U.S. 483, 488-93 (1987); *Southland Corp.*, 465 U.S. at 10-17

A brief history of the arbitration-specific unconscionability doctrine employed by the California Supreme Court—both before and after *Concepcion*—will provide useful context for assessing California's resistance to this Court's FAA precedents:

1. ***Armendariz.*** In *Armendariz*, the California Supreme Court held that as a matter of state public policy courts can refuse to enforce mandatory employment agreements to arbitrate unwaivable state statutory claims for employment discrimination if they deem the arbitration clause at

issue to be unconscionable. 24 Cal. 4th at 90-91, 99-103, 6 P.3d at 674, 679-82. Rather than apply general principles of unconscionability law to make that determination, the court instead invented arbitration-specific rules mandating a "modicum of bilaterality" in arbitration—i.e., that an arbitration clause required as a condition of employment must apply to both claims more likely to be brought by an employer and claims more likely to be brought by an employee. *Id.* at 117-19, 6 P.3d at 692-93. In reaching the conclusion that an arbitration clause cannot be too one-sided, the California Supreme Court rejected the notion that its version of unconscionability law impermissibly "takes its meaning precisely from the fact that a contract to arbitrate is at issue," *Perry*, 482 U.S. at 492 n.9, and thus was preempted by the FAA. Instead, it held that "ordinary principles of unconscionability may manifest themselves in forms peculiar to the arbitration context." *Armendariz*, 24 Cal. 4th at 119, 6 P.3d at 693.

Applying this standard, the California Supreme Court concluded the arbitration agreement in *Armendariz* was "unconscionably unilateral" where it violated state public policy. *Id.* at 91, 121, 6 P.3d at 674, 694.

2. ***Little.*** Several years after *Armendariz*, in *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 63 P.3d 979 (2003), the California Supreme Court reiterated *Armendariz*'s state public policy limitation on the enforceability of arbitration agreements governed by the FAA, and further developed California's arbitration-specific unconscionability rules. *See id.* at 1071-81, 63 P.3d at 983-90. *Little* held that one type of

substantively unconscionable arbitration clause originates with "the party imposing arbitration [who] mandates a post-arbitration proceeding, either judicial or arbitral, wholly or largely to its benefit at the expense of the party on which the arbitration is imposed." *Id.* at 1072, 63 P.3d at 984. The court then invalidated a contractual term authorizing either party to appeal to a second arbitrator from an arbitral award exceeding $50,000, concluding it would unduly favor defendants over plaintiffs. *Id.* at 1071 74, 63 P.3d at 983-85.

3. ***Discover Bank.*** Two years later, in *Discover Bank*, the California Supreme Court addressed whether courts may invalidate class action arbitration waivers pursuant to an unconscionability defense. 36 Cal. 4th at 152-53, 160-63, 113 P.3d at 1103, 1108-10. The California Supreme Court held that because class actions and arbitrations are "often inextricably linked to the vindication" of substantive state rights, class arbitration waivers are contrary to California public policy and therefore unconscionable when class actions are the only effective way to halt and redress wrongful conduct. *Id.* at 160-63, 113 P.3d at 1108-10. *Discover Bank* held that the FAA did not preempt its unconscionability holding because, while specifically tailored to arbitration agreements, the unconscionability determination could be traced to a general state public policy against exculpatory contracts. *See id.* at 163-67, 113 P.3d at 1110-13.

4. ***Sonic I.*** In *Sonic-Calabasas A, Inc. v. Moreno* (*Sonic I*), 51 Cal. 4th 659, 247 P.3d 130 (2011), a decision issued just two months before *Concepcion*, the California Supreme Court concluded that an

agreement to resolve disputes through arbitration impermissibly waived the "advantages" of certain procedures that California laws made available to employees who pursue state statutory wage claims in an administrative proceeding before the state Labor Commissioner's office. *See id.* at 668-69, 671-72, 679, 681 n.4, 247 P.3d at 133-35, 140-41, 142 n.4. The California Supreme Court concluded that substituting arbitration as an alternative to the Labor Commissioner procedures violated California public policy and rendered the agreement unconscionable as written. *Id.* at 678-84, 686-87, 247 P.3d at 140-44, 145-46. Applying the reasoning of *Discover Bank*, the court also held that this result was not preempted by the FAA. *Id.* at 687-95, 247 P.3d at 146-52.

5. ***Sonic II.*** This Court vacated *Sonic I* and remanded for reconsideration in light of *Concepcion*. *See Sonic-Calabasas A, Inc. v. Moreno*, 132 S. Ct. 496 (2011). On remand, the California Supreme Court addressed whether any barrier to the vindication of a plaintiff's right to recover unpaid wages under California law "would make the arbitration agreement unconscionable or otherwise unenforceable . . . and, if so, whether such a rule would be preempted by the FAA." *Sonic-Calabasas A, Inc. v. Moreno* (*Sonic II*), 57 Cal. 4th 1109, 1142, 311 P.3d 184, 200 (2013).

The California Supreme Court noted that, when an employee elects to pursue his state statutory right to recover unpaid wages before the Labor Commissioner rather than in court, state law affords the employee certain hearing and posthearing procedures that are designed to "reduc[e] the costs and risks of pursuing a wage claim in several ways." *Id.* at

1129, 311 P.3d at 191. The court held it appropriate to consider whether agreed-upon arbitration procedures fail to include these statutory procedures, and whether the absence of these procedures fails to "provide an employee with an accessible and affordable arbitral forum for resolving wage disputes." *Id.* at 1146, 311 P.3d at 203.

In the court's view, this unconscionability standard survived FAA preemption even after *Concepcion* and *Italian Colors*. Relying on *Armendariz*, which preceded both decisions, the majority maintained that the FAA allows state courts to refuse to enforce agreements to arbitrate state statutory claims where arbitration would not afford procedural benefits that plaintiffs would have received outside arbitration. *Id.* at 1150-52, 311 P.3d at 206-08 (citing *Armendariz*, 24 Cal. 4th at 98-99, 6 P.3d at 679-80).

Justice Chin's dissenting opinion explained that the majority's decision—which concluded that courts have the power to create state-law rules "uniquely in the context of arbitration," *id.* at 1143, 311 P.3d at 201 (majority opinion)—impermissibly applied a state-law contract defense to an arbitration agreement based on the uniqueness of that agreement, *id.* at 1190-91, 311 P.3d at 235 (Chin, J., concurring in part & dissenting in part). However, "a court may not 'rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . the state legislature cannot.'" *Concepcion*, 563 U.S. at 340 (citation omitted). Such an arbitration-specific rule is preempted by the FAA because it has "a

disproportionate impact on arbitration agreements." *Id.* at 341. By grounding its analysis on an unconscionability standard that is peculiar to arbitration, *Sonic II*'s development of a "unique rule" for arbitration agreements flouted *Concepcion*. *Sonic II*, 57 Cal. 4th at 1190-91, 311 P.3d at 235 (Chin, J., concurring in part & dissenting in part).

6. ***Sanchez.*** Most recently, in *Sanchez v. Valencia Holding Co.*, 61 Cal. 4th 899, 353 P.3d 741 (2015), the California Supreme Court reversed a lower court decision holding an arbitration agreement in an automobile sales contract unenforceable on unconscionability grounds. But the California Supreme Court reaffirmed that arbitration provisions *may* be found unconscionable if they "'contravene the public interest or public policy,'" *id.* at 911, 353 P.3d at 748 (citation omitted), and approved "using [the] unconscionability doctrine on a case-by-case basis to protect . consumers against fees that unreasonably limit access to arbitration," *id.* at 920, 353 P.3d at 755.

The California Supreme Court rejected the premise that the FAA preempts such unconscionability rules after *Concepcion*. *See id.* at 906-07, 912-13, 920-21, 353 P.3d at 745-46, 749-50, 755-56. The court emphasized that the FAA does not preempt unconscionability defenses, *id.* at 906, 353 P.3d at 745-46, even though *Concepcion* had concluded the FAA preempted *Discover Bank*'s unconscionability rules, *Concepcion*, 563 U.S. at 337-51. Adhering to *Sonic II*'s interpretation of *Concepcion*, the court held that the FAA does not preclude states from applying their unconscionability rules to ensure that the "arbitral scheme set forth in a contract is in practice 'an

accessible, affordable process for resolving . . disputes.'" *Sanchez*, 61 Cal. 4th at 921, 353 P.3d at 756 (citation omitted).

In his dissenting opinion, Justice Chin noted that after *Italian Colors*, it is clear "the FAA preempts the majority's rule insofar as it makes a 'substantial deterrent effect' sufficient to establish substantive unconscionability." *Id.* at 942, 353 P.3d at 770 (Chin, J., concurring in part & dissenting in part). The dissent further explained that under this Court's "binding precedent, if a cost provision does not impose fees that 'make access to the forum impracticable' . . then the FAA precludes a court from invalidating it as unconscionable because of a subjective determination that it will, in a particular case, 'have a substantial deterrent effect' on a party's exercise of the right to request a second arbitration." *Id.* at 942, 353 P.3d at 770-71 (Chin, J., concurring in part & dissenting in part) (citations omitted).

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Consistent with its own arbitration unconscionability jurisprudence, the California Supreme Court has given California's intermediate appellate courts virtually free rein in using the unconscionability doctrine to resist *Concepcion*. In multiple cases in which California's intermediate appellate courts have invalidated arbitration agreements on the ground they are substantively unconscionable, the California Supreme Court has denied review, allowing such decisions to stand. *See, e.g., Pinela v. Neiman Marcus Grp., Inc.*, 238 Cal. App. 4th 227, 250, 190 Cal. Rptr. 3d 159, 178-79 (2015),

review denied, Sept. 16, 2015; *Elite Logistics Corp. v. Wan Hai Lines, Ltd.*, B252543, 2015 WL 3522606, at *1 (Cal. Ct. App. June 4, 2015), *review denied*, Sept. 9, 2015; *Woods v. JFK Mem'l Hosp., Inc.*, G050286, 2014 WL 5475231, at *1 (Cal. Ct. App. Oct. 30, 2014), *review denied*, Jan. 21, 2015; *Samaniego v. Empire Today LLC*, 205 Cal. App. 4th 1138, 1141-42, 140 Cal. Rptr. 3d 492, 495 (2012), *review denied*, July 11, 2012; *Wherry v. Award, Inc.*, 192 Cal. App. 4th 1242, 1245, 123 Cal. Rptr. 3d 1, 3 (2011), *review denied*, Apr. 27, 2011.

The Ninth Circuit has sided with California courts in determining that California's application of the unconscionability doctrine to invalidate arbitration agreements is not preempted by the FAA. In *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916 (9th Cir. 2013), which the panel below found controlling when it rejected the petitioner's FAA preemption arguments in the present case, *see* Pet. App. 5a-6a, the Ninth Circuit applied the unconscionability rules articulated by the California Supreme Court in *Armendariz* to hold unconscionable an arbitration provision that effectively gave the power to select the arbitrator to the party not requesting arbitration. The Ninth Circuit acknowledged that "the FAA preempts state laws having a 'disproportionate impact' on arbitration" and that "any state law that invalidated this provision would have a disproportionate impact on arbitration because the term is arbitration specific." *Id.* at 927. But the court reasoned that state law must be able to "require some level of fairness in an arbitration agreement" and that the "FAA does not preempt [California law's] invalidation of [the]

arbitration policy" so long as it "reflects a generally applicable [state] policy against abuses of bargaining power." *Id.*

D. California's unconscionability standards are preempted because they permit courts to invalidate arbitration agreements based on state policy concerns about fairness.

Although California courts have employed a variety of verbal formulations to describe the standard for determining whether a contract is substantively unconscionable, "all mean the same thing": "[t]he ultimate issue in every case is whether the terms of the contract are sufficiently unfair, in view of all relevant circumstances, that a court should withhold enforcement." *Sanchez*, 61 Cal. 4th at 911-12, 353 P.3d at 749.

But normative judgments about the fairness of arbitration procedures are not a basis for invalidating arbitration agreements governed by the FAA. A court's determination that an arbitration agreement is "sufficiently unfair" under state law—and therefore unconscionable—embodies little more than a *state* policy judgment about the efficacy of arbitration as a forum for vindicating a plaintiff's rights. *See, e.g.*, *id.* at 911 12, 353 P.3d at 748-49 (holding that contract's terms are unconscionable if they "contravene the public interest or public policy"); *Sonic II*, 57 Cal. 4th at 1145-46, 1154-55, 311 P.3d at 202-03, 209 (unconscionability rules are concerned with whether terms "'contravene the public interest or public policy'" and courts may therefore consider whether the parties' agreed-upon arbitration procedures are unconscionable if they fail

to include procedural protections available to an employee outside of arbitration as those protections would help "vindicate" the employee's state statutory rights (citation omitted)). As commentators have noted, the California Supreme Court has expressed "deeply rooted doubts regarding the fairness of arbitration," especially "in an employment setting." Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 84.

After *Concepcion*, such a policy judgment clashes with the FAA's mandate that courts enforce arbitration agreements according to their terms. As this Court recently confirmed, the FAA requires courts to "'rigorously enforce' arbitration agreements according to their terms," including the terms setting "the rules under which that arbitration will be conducted." *Italian Colors*, 133 S. Ct. at 2309 (citations omitted). In other words, the FAA itself imposes a binding policy judgment, which cannot be superseded by state public policy in the guise of an unconscionability rule. *See Concepcion*, 563 U.S. at 350 ("States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."); *see also id.* at 354-56 (Thomas, J., concurring) (concluding that the FAA preempted a California unconscionability rule grounded in state public policy because a state's "public policy" concerns "could not be the basis for declining to enforce an arbitration clause" under the FAA).

Consistent with the FAA, therefore, courts cannot invalidate arbitration agreements based on a

finding that the agreement is insufficiently fair as a matter of state policy, as embodied in the state's unconscionability standards. *See THI of N.M. at Hobbs Ctr., LLC v. Patton*, 741 F.3d 1162, 1169-70 (10th Cir. 2014) (where arbitration agreement is allegedly unconscionable because it is unfair, "the heart of the asserted unfairness is the disparity" between arbitration and litigation outside the arbitral forum and the supposed lack of fairness therefore reflects a state "policy hostile to arbitration" that is "'impermissible'" under the FAA (citation omitted)). Accordingly, California's formulations of the unconscionability standard—based as they are on an assessment of fairness as a matter of state policy—conflict with *Concepcion*, *Italian Colors*, and the decisions of lower courts that have faithfully followed the Supreme Court's interpretation of the FAA.

E. The FAA also preempts the specific unconscionability standard that was applied here because it relies on the uniqueness of an arbitration agreement and has a disproportionate impact on such agreements.

The formulation of the unconscionability standard that the district court and the Ninth Circuit applied in this case is an especially egregious rule at odds with *Concepcion* and *Italian Colors*. The district court, citing the California Supreme Court's decision in *Armendariz*, concluded that "[a]n arbitration provision is substantively unconscionable if it is 'overly harsh' or generates "'one-sided results.'" Pet. App. 19a. The Ninth Circuit likewise looked to whether any arbitration provision was "'unjustifiably one-sided.'"

Pet. App. 3a. Although the panel quoted the Ninth Circuit's earlier decision in *Chavarria* for this unconscionability rule, *id.*, *Chavarria* simply applied the unconscionability rules from *Armendariz* and its progeny, *Chavarria*, 733 F.3d at 921-23.

But as the California Supreme Court itself acknowledged before *Concepcion* was decided, an unconscionability standard that focuses on whether an employment agreement to arbitrate statutory claims is too "one-sided" is "peculiar to the arbitration context." *Armendariz*, 24 Cal. 4th at 117-20, 6 P.3d at 692-94; *see Gray v. Conseco, Inc.*, No. SA CV 00-322 DOC (EEX), 2000 WL 1480273, at *4 (C.D. Cal. Sept. 29, 2000) ("Under California law, other non-mutual contract provisions are valid and not unconscionable. The language used by the California Supreme Court in the *Armendariz* opinion itself demonstrates that the rule singles out and imposes a special burden on arbitration agreements . . ." (citation omitted)). This is so because it turns on an examination of whether an employer has "impose[d] a system of arbitration on an employee that seeks to maximize the advantages and minimize the disadvantages of arbitration for itself at the employee's expense." *Armendariz*, 24 Cal. 4th at 118-20, 6 P.3d at 692-94.

As commentators have observed, "California courts—and the Ninth Circuit—have taken the FAA's 'savings clause' where no court ha[d] gone before" *Armendariz*. McGuinness & Karr, *supra*, at 62. "With only a few exceptions, arbitration agreements that have been evaluated under California's post-*Armendariz* law have been held invalid under the 'generally applicable contract defense' of

unconscionability." *Id.* Based on *Armendariz* and its progeny, "[t]he FAA's savings clause, which was enacted with the aim of placing arbitration agreements 'on equal footing with other contracts,' is now used as the platform to strike them down in legion." *Id.*

The California Supreme Court's view that its arbitration-specific "modicum of bilaterality" test is not preempted by the FAA is wholly untenable. *See Concepcion*, 563 U.S. at 341-42 (state courts may not use unconscionability doctrine to impose particular arbitral procedures based on perception they will prevent one party from having an undue advantage in arbitration over the other); *see also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30 (1991) (holding that "challenges to the adequacy of arbitration procedures" in arbitration agreements governed by the FAA were "insufficient to preclude arbitration of statutory claims").

Indeed, *Concepcion* held "that a court may not 'rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.'" *Concepcion*, 563 U.S. at 341 (citation omitted). As an illustration of such a prohibited unconscionability standard, this Court disapproved state-law doctrines finding unconscionable agreed-upon arbitration procedures that "would be of greater benefit" to the defendant than to the plaintiff. *Id.* at 341-42. *Concepcion* pointed out that while such a mutuality rule is nominally a generally applicable contract defense in that it applies to "'any' contract," the rule would "[i]n practice have a disproportionate impact on arbitration agreements . " *Id.* at 342. Thus, a court cannot

disapprove on unconscionability grounds a provision that merely specifies the procedures to be followed, even if that provision benefits one party more than another, because the FAA protects the right of parties to arbitrate according to specific rules or to limit the issues to be arbitrated. *See id.* at 343-45 (recognizing that the FAA protects parties' right to limit the issues to be arbitrated, to arbitrate according to specific rules, and to limit with whom they will arbitrate).

Hence, after *Concepcion*, the FAA preempts an unconscionability test that relies on the uniqueness of an arbitration agreement by deeming such an agreement unconscionable, and therefore unenforceable, because the arbitration procedures set by the agreement are too one-sided. As Justice Chin's dissenting opinion in *Sanchez* explained, "the FAA *requires* that [California's] standard for unconscionability be 'the same for arbitration and nonarbitration agreements,'" but the California Supreme Court "first articulated the 'unfairly one-sided' formulation [of the unconscionability test] specifically in the context of an unconscionability challenge *to an arbitration provision*, and the formulation has since been used almost exclusively in that context." *Sanchez*, 61 Cal. 4th at 937, 353 P.3d at 767 (Chin, J., concurring in part & dissenting in part) (citation omitted). Under *Concepcion*, the FAA sweeps away unconscionability rules that "have a disproportionate impact on arbitration agreements," even if they are rules that would supposedly apply to all contracts. *Concepcion*, 563 U.S. at 342.

It is this rigid bilaterality standard's peculiar focus on the uniqueness of an arbitration agreement

that led the Alabama Supreme Court to refuse to adopt such a rule on the ground it was barred by the FAA. *See Ex parte McNaughton*, 728 So. 2d 592, 598-99 (Ala. 1998). As the Alabama Supreme Court explained, the standard "directly depends on arbitration for its application" and therefore impermissibly "assigns a suspect status to arbitration agreements." *Id.* at 598; *see also Reed Elsevier, Inc. ex rel. LexisNexis Div. v. Crockett*, 734 F.3d 594, 600 (6th Cir. 2013) (arbitration procedure could not be found unconscionable so as to defeat FAA preemption, even though arbitration clause was adhesive and one-sided, because "all of these things—the one-sided nature of the arbitration clause, and its adhesive nature—were also present" in *Italian Colors*, which found an arbitration agreement enforceable "all of those concerns notwithstanding"); *Gray*, 2000 WL 1480273, at *4 ("out of deference to the federal policy favoring arbitration," refusing to apply *Armendariz*'s unconscionability test because it "singles out and imposes a special burden on arbitration agreements"); *Torrence v. Nationwide Budget Fin.*, 753 S.E.2d 802, 811-12 (N.C. Ct. App. 2014) (after *Concepcion*, "the one-sided quality of an arbitration agreement is not sufficient to find it substantively unconscionable" in cases governed by the FAA).

Empirical data confirms that an unconscionability standard that takes its meaning precisely from the fact that an agreement to arbitrate is at issue will necessarily have a disproportionate impact on arbitration agreements. Based on a study of California unconscionability jurisprudence that this Court cited in *Concepcion*, 563 U.S. at 342-43, one commentator has explained that "California courts are

clearly biased against arbitration as an alternative means of dispute settlement" and "[t]heir disdain manifests" in the standard they apply to assess whether arbitration agreements are enforceable. Broome, *supra*, at 41. The Broome study demonstrated that the unconscionability standard used by the Ninth Circuit in this case imposes "arbitration-specific" requirements and that, under California's jurisprudence predating *Concepcion*, "'unconscionable' means something quite different when the validity of an arbitration agreement is at issue." *Id.* at 53-55, 67-68.

A follow-up study of 119 California state court decisions issued between 2005 and 2008 made findings that "confirm[ed] those of Professor Broome." Paul Thomas, Note, *Conscionable Judging: A Case Study of California Courts' Grapple with Challenges to Mandatory Arbitration Agreements*, 62 Hastings L.J. 1065, 1082-84 (2011). The data shows that under California law "very few contracts are voided as unconscionable—unless they can be classified as 'agreements to arbitrate which appear to be biased against the weaker party.'" *Id.* at 1070. This study concluded that in California "unconscionability challenges to arbitration agreements succeed at a higher rate than unconscionability challenges to other agreements," *id.* at 1074, and that "[c]ourts applying California law are most likely discriminating against arbitration agreements in a manner that is preempted by the interpretation of the FAA advanced by the Supreme Court," *id.* at 1084; *see also* McGuinness & Karr, *supra*, at 62 ("California has created a new brand

of unconscionability. It is far more demanding—and it is unique to arbitration.").

This phenomenon is not limited to California. A nationwide analysis of federal and state court decisions between the years 1994 and 2007 found that as this Court has closed off other means of resisting arbitration, state law unconscionability doctrines have become "new tools" that are "being used to limit arbitration" and strike down arbitration agreements. Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. Rev. 1420, 1440-43 & n.85 (2008). "Where unconscionability challenges once appeared in less than 1% of all arbitration-related cases, more recently they have appeared in 15-20% of all cases involving arbitration." *Id.* at 1441; *see also* Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 194 (2004) (concluding that after this Court had blocked other challenges to arbitration, unconscionability challenges to arbitration agreements came to represent two-thirds of all unconscionability challenges (161 out of 235) and succeeded at twice the rate of unconscionability arguments directed at other types of contracts); Stephen J. Ware, *Arbitration and Unconscionability After* Doctor's Associates, Inc. v. Casarotto, 31 Wake Forest L. Rev. 1001, 1034 (1996) ("Judicial decisions apply unconscionability, and other common law doctrines, more aggressively to arbitration agreements than to other contracts.").

Disproportionate application of the unconscionability doctrine to arbitration agreements can be explained only as a manifestation of hostility to

arbitration. "[I]t is well known that unconscionability is generally a loser of an argument" and in the non-arbitration context "has been mostly in intellectual retreat for various reasons." Bruhl, *supra*, at 1442. The increasing use of unconscionability has therefore "been aptly described by scholars as an attempt, using one of the few tools remaining, to put the brakes on the pro-arbitration trend and restore some sort of balance." *Id.* at 1442-43. Because "it will often be nearly impossible to tell if a court is applying state unconscionability doctrine evenhandedly in the way the FAA requires," unconscionability provides a means for courts "to misapply, or perhaps even manipulate, state contract doctrines so as to nullify arbitration agreements while simultaneously frustrating the ability of reviewing courts to reverse." *Id.* at 1422, 1449.

II. RATHER THAN APPLYING ILL-DEFINED STANDARDS OF FAIRNESS BASED ON STATE PUBLIC POLICY, COURTS SHOULD DEEM ARBITRATION AGREEMENTS UNCONSCIONABLE ONLY WHEN REQUIRED BY DUE PROCESS.

Some argue that arbitration provisions are found unconscionable more often than ordinary contract provisions because they actually *are* more often unfair than other types of provisions, apart from the requirement of arbitration itself. But even if that were true—and there is no evidence that is the case[4]—

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[4] As this Court has explained, "streamlined procedures of arbitration do not entail any consequential restriction on (continued...)

it would not justify courts in applying freewheeling and subjective unfairness standards based on state public policy to advance preferred outcomes while evading review on FAA preemption grounds.[5]

Assessing whether an arbitration agreement is insufficiently fair—and therefore unconscionable—embodies a state policy judgment about the utility of arbitration in vindicating rights. *See supra*, at 8-11. Under *Concepcion*, such policy judgments cannot override the FAA's mandate requiring courts to enforce

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(...continued)
substantive rights." *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 232 (1987). "[T]here is nothing inherently unfair or oppressive about arbitration clauses." *Coleman v. Prudential Bache Sec.*, 802 F.2d 1350, 1352 (11th Cir. 1986). Thus, an "employee's 'generalized attacks' on 'the adequacy of arbitration procedures'" are "insufficient to preclude arbitration of statutory claims." *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 258 (2009) (citation omitted).

[5] The glaring and untenable inconsistencies that can result from such subjective policy judgments are illustrated by *Woods*, 2014 WL 5475231, in which a California intermediate appellate court found an arbitration agreement to be substantively unconscionable because it lacked sufficient mutuality and was unfairly one-sided. *Id.* at *6-*8. But the very same (or materially similar) arbitration agreement has been held enforceable by multiple other California appellate courts, including by a different, earlier panel of the same appellate court that decided *Woods*: *Willis v. Prime Healthcare Servs., Inc.*, 231 Cal. App. 4th 615, 618-34, 180 Cal. Rptr. 3d 297, 298-310 (2014); *McElroy v. Tenet Health Care Corp.*, G047300, 2013 WL 4482928, at *3-*6 (Cal. Ct. App. Aug. 21, 2013); *Mercado v. Doctors Med. Ctr. of Modesto, Inc.*, F064478, 2013 WL 3892990, at *2-*8 (Cal. Ct. App. July 26, 2013); *accord Jaffe v. Zamora*, 57 F. Supp. 3d 1244, 1245-48 (C.D. Cal. 2014).

arbitration agreements according to their terms. To adhere to this directive, yet protect against truly unconscionable arbitration terms, this Court should require state courts applying an unconscionability analysis to do so based on constitutional due process standards, rather than on ill-defined and inherently subjective assessments of whether an arbitration agreement is insufficiently fair. The FAA already contains restrictions on arbitration procedures that are designed to protect such due process rights. *See* 9 U.S.C. §§ 10-11 (2012). Those statutory protections, supplemented as appropriate by due process jurisprudence, should be the basis for any substantive unconscionability standard in the arbitration context.

Under the FAA, a fundamentally fair arbitration is one that occurs with proper "notice" of the arbitration and the "opportunity to be heard and to present relevant and material evidence and argument" before arbitrators who "are not infected with bias." *Bowles Fin. Grp. v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1012-13 (10th Cir. 1994); *see Tempo Shain Corp. v. Bertek, Inc.*, 120 F.3d 16, 20 (2d Cir. 1997) (section 10(a)(3) of the FAA codifies a "fundamental fairness" standard pursuant to which "an arbitrator 'must give each of the parties to the dispute an adequate opportunity to present its evidence and argument'" (citation omitted)). Such restrictions (along with others) that are codified as part of the FAA for actions pending in federal court, *e.g.*, 9 U.S.C. § 10(a)(2)-(3), are considered due process limitations. *See Biller v. Toyota Motor Corp.*, 668 F.3d 655, 663-64 (9th Cir. 2012) (grounds for vacatur of arbitration award under FAA are "'designed to preserve due process'" (citation

omitted)); *Prudential Sec., Inc. v. Dalton*, 929 F. Supp. 1411, 1417 (N.D. Okla. 1996) ("fundamental fairness" restrictions on "arbitration process" are "fundamental due process" limitations).

These fairness limitations are "not to be equated with the full panoply of judicial procedural safeguards and legal 'niceties' of the courtroom" because "[d]ue process in arbitration means satisfying 'minimal requirements of fairness.'" *McMahan & Co. v. Dunn Newfund I, Ltd.*, 656 N.Y.S.2d 620, 621, 230 A.D.2d 1, 4 (App. Div. 1997) (citation omitted). But that is by congressional design, and state court efforts based on state public policies of fairness that attempt to impose procedures more closely approximating courtroom litigation upend the balance Congress sought to achieve when taking into account the parties' right to control the terms under which their disputes will be resolved. *See Concepcion*, 563 U.S. at 341-44, 350-52.

Whatever limitations arbitration agreements may typically impose on arbitration procedures, these agreements "are a far cry from the overtly oppressive contracts traditionally policed by courts under the doctrine of unconscionability." McGuinness & Karr, *supra*, at 90. If an agreement includes unfair limitations, they can be readily redressed through the due process protections for fairness already built into the FAA by Congress. Should a case present a highly unusual problem of unfairness that reaches constitutional due process dimensions but that is not already addressed in the FAA, then the FAA will, of course, have to give way. *See City of Boerne v. Flores*, 521 U.S. 507, 529 (1997). Constitutional due process protections trump the congressional dictates of the

FAA. And a body of due process jurisprudence exists for courts to draw upon in ascertaining whether a party has been deprived of adequate notice and an opportunity to be heard. If such a deprivation has not occurred, however, state courts may not refuse to enforce arbitration agreements under a substantive unconscionability standard predicated on subjective state policy judgments about fairness, however formulated.

III. THE SEVERABILITY RULE CALIFORNIA COURTS APPLY TO ARBITRATION AGREEMENTS IS PREEMPTED UNDER THE FAA.

Even if this Court were to limit its focus in this case to determining whether the severability principle applied by the Ninth Circuit is preempted by the FAA, it should still reverse the opinion below because California's arbitration-specific severability rule disproportionately invalidates arbitration agreements.

In *Armendariz*, 24 Cal. 4th at 124, 6 P.3d at 696-97, the California Supreme Court held that where "the arbitration agreement contains more than one unlawful provision," that inherently "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." The California Supreme Court further held that, in that circumstance, a court may refuse to sever the unconscionable provisions on the ground that the entire arbitration agreement is "permeated by an unlawful purpose." *Id.*, 6 P.3d at 697.

Ever since *Armendariz*, California courts have applied this arbitration-specific severability rule in a mechanical way to disfavor arbitration agreements. *See, e.g.*, *Pinela*, 238 Cal. App. 4th at 256, 190 Cal. Rptr. 3d at 183-84 (stating severance is appropriate "where only one clause in an arbitration agreement [is] found to be substantively unconscionable," but refusing to sever where "multiple provisions" were found unconscionable); *Trivedi v. Curexo Tech. Corp.*, 189 Cal. App. 4th 387, 398, 116 Cal. Rptr. 3d 804, 812-13 (2010) (following *Armendariz* in refusing to sever multiple unconscionable provisions in arbitration agreement because that is "a circumstance considered by [the California] Supreme Court to 'permeate' the agreement with unconscionability"); *Fitz v. NCR Corp.*, 118 Cal. App. 4th 702, 726, 13 Cal. Rptr. 3d 88, 106 (2004) (refusing to sever multiple unconscionable arbitration provisions, holding "[i]n *Armendariz* the California Supreme Court held that more than one unlawful provision in an arbitration agreement weighs against severance").

By contrast, California courts have not applied any presumption against severance outside the context of arbitration agreements. Indeed, with non-arbitration contracts, "California cases take a very liberal view of severability, enforcing valid parts of an apparently indivisible contract where the interests of justice or the policy of the law would be furthered." *In re Marriage of Facter*, 212 Cal. App. 4th 967, 987, 152 Cal. Rptr. 3d 79, 95 (2013) (citation omitted); *see also Marathon Entm't, Inc. v. Blasi*, 42 Cal. 4th 974, 996-98, 174 P.3d 741, 743-44 (2008) (applying more liberal approach to sever unlawful provisions of non-

arbitration contract). The presumption in favor of severance is particularly strong where a contract (like the arbitration agreement here) contains a severability clause, which "evidence[s] the parties' intent that, to the extent possible, the valid provisions of the contracts be given effect, even if some provision is found to be invalid or unlawful." *Facter*, 212 Cal. App. 4th at 985, 152 Cal. Rptr. 3d at 94 (citation omitted).

In short, California law applies a de facto presumption *against* severance to arbitration agreements that contain multiple unconscionable provisions but a de facto presumption *in favor of* severance to non-arbitration contracts containing multiple unconscionable provisions. The California severability doctrine thus disproportionately burdens arbitration agreements and is therefore preempted by the FAA. *See Concepcion*, 563 U.S. at 341-42.

CONCLUSION

The judgment of the Court of Appeals for the Ninth Circuit should be reversed.

Respectfully submitted,

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